Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM:SF:POSTF114951-02
GMFerreira

date: April 15, 2002

to: Mark Mertens, Senior Team Coordinator, (LMSB)
Internal Revenue Service
Stop SF-6107; EG 1232
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from: Area Counsel
(Communications, Technology, and Media: Oakland)

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subject: [redacted] **Corporation and Includible Subsidiaries**
EIN# [redacted]
Tentative Refund of Net Operating Losses FYE [redacted], [redacted] **and** [redacted]

Disclosure Statement

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney/ client privilege. If disclosure becomes necessary, please contact this office for our recommendations.

This advice relies upon facts provided by you to our office. If you find that any facts are incorrect, please advise us immediately so that we may modify and correct this advice. We have assumed that there are no changes in the taxpayer's organizational structure that would affect the conclusions reached in this memo.

This advice is subject to the 10-day post-review by the National Office pursuant to CCDM 35.3.19.4. Accordingly, we request that you do not act on this advice until we have advised you of the National Office's comments concerning this advice.

ISSUE

1. Has the IRS made an erroneous refund of $[redacted] paid to [redacted] Corporation (EIN [redacted]) as a result of an application for a tentative refund filed by [redacted]

Company (EIN) on ?

2. Can the IRS seek recovery of the tentative refund of $ from either (EIN), as agent for Corporation (EIN) and/or from Corporation (EIN , as successor in interest to Corporation (EIN) through deficiency procedures?

CONCLUSION

1. The IRS has not made an erroneous refund of $ paid to Corporation (EIN) as a result of an application for a tentative refund filed by Company (EIN) on .

2. If the IRS later determines that the tentative refund of $ paid to Corporation (EIN) on is not allowable, the IRS may seek recovery of the tentative refund from both (EIN) as agent for Corporation (EIN , and from Corporation (EIN), as successor in interest to Corporation (EIN through deficiency procedures.

FACTS

On , , a publicly-held company, acquired Corporation and its subsidiaries. Corporation (EIN ("Old "), the parent of the consolidated group, was merged into Corporation (EIN , a wholly-owned subsidiary of . Thereafter, Old ceased to exist. Corporation immediately changed its name to Corporation, ("New ") and retained EIN .

New became the common parent of an affiliated group of companies. Specifically, New was the common parent of the sub group, Company (" ") (EIN), and other affiliated groups.

Prior to the merger, Old and its subsidiaries filed one return, a consolidated return. After the acquisition, New could no longer file a single

return per Treas. Reg. § 1.1502-47(d)(12)(iv), and the [redacted] subgroup, [redacted], elected to file its own consolidated return, beginning the short period [redacted] to [redacted]. New [redacted] and the [redacted] subgroups filed its first consolidated return beginning the short period [redacted] to [redacted].

During [redacted] and [redacted], New [redacted] sent separate requests to the District Director, Northern California District, enclosing designations by the remaining corporations that were members of the affiliated group of which Old [redacted] was the common parent, for each of the periods from [redacted] through [redacted] designating another member of the group to act as agent for the group, under Treas. Reg. § 1.1502-77(d). The agent designated to act on behalf of Old [redacted] was [redacted] Corporation ([redacted]), ("[redacted]"), EIN [redacted]. The designation of [redacted] was approved by the District Director, Northern California District, by letter dated [redacted], for the periods ending [redacted] through [redacted]. (See Exhibit A).

Advice was previously sought from this office requesting an opinion regarding securing consents to extend the statutes for Old [redacted]'s returns for the years ending December 31, [redacted] ([redacted]) and [redacted] ([redacted]) since Old [redacted] was no longer the common parent for the group. We recommended in [redacted] that consents to extend the [redacted] and [redacted] years be secured by both New [redacted], as successor to Old [redacted], and by [redacted], as alternative agent for Old [redacted]. (See Exhibit B).

On the first [redacted] consolidated return filed after the acquisition, for the short period from [redacted] to [redacted], [redacted] claimed a deduction for stock options expenses of $[redacted], with a net negative taxable income of ($[redacted]), and a net operating loss available for carryback of $[redacted].

On [redacted], [redacted] filed a Form 1139, "Corporation Application for Tentative Refunds," carrying back a net operating loss of $[redacted], a net capital loss of $[redacted], and unused general business credits of $[redacted], for the period ended December 31, [redacted] to Old [redacted]'s consolidated returns for the [redacted], [redacted], and [redacted] periods. The tentative refunds reflected on [redacted]'s Form 1139 were $[redacted], $[redacted], and $[redacted] for [redacted], [redacted] and [redacted], respectively. The total amount of the tentative refund for [redacted], [redacted] and [redacted] was $[redacted]. (Exhibit C).

On [redacted] a Form 8302, "Application for Electronic Funds Transfer (EFT) of Tax Refund of $[redacted]" was filed by [redacted] Corporation and Includible Subsidiaries, using Old [redacted]'s EIN [redacted] (Exhibit D). On [redacted], the $[redacted] of the net operating loss carryback filed by [redacted], EIN [redacted], was transferred to [redacted] account #[redacted]. (Exhibit E). The [redacted] account was owned by New [redacted], EIN [redacted]. The tentative refund of $[redacted] was credited by the Internal Revenue Service to the account of Old [redacted], EIN [redacted] for the [redacted] and [redacted] periods.

DISCUSSION

Issue 1: Erroneous Refund

I.R.C. § 7405 allows the United States to recover any portion of a refund that has been erroneously made to a taxpayer. The statute of limitations for filing an erroneous refund claim against New [redacted] for the recovery of the $[redacted] tentative refund will expire on [redacted]. I.R.C. § § 6532(b) and 7405.

I.R.C. § 6411(a) authorizes a corporation that has sustained a net operating loss (NOL) to apply for a tentative carryback adjustment of the tax for the prior taxable year to which the NOL is carried. The application of I.R.C. § 6411, however, is subject to such conditions, limitations, and exceptions as prescribed by regulation when the applicant made, or was required to make, a consolidated return either for the year in which the NOL arose, or for the prior taxable year to which the NOL is carried. See I.R.C. § 6411(c) and Treas. Reg. § 1.6411-4.

The predecessor of I.R.C. § 6411 was enacted in 1945, and the Committee Report declared its purpose was to make funds available promptly to corporations that needed them. H. Rept. No. 849, 79th Cong., 1st Sess., 1945 C. B. 566, 569. To assure that the Internal Revenue Service would act promptly on such an application, I.R.C. § 6411(b) requires the government to act within a 90-day period and limits the scope of IRS's review to an "examination of the application, to discover omissions and errors of computation therein." However, because the government's review of the application is limited, the allowance of an adjustment is tentative. H. Rept. No. 849, *supra* at 1945 C. B. 580-583. To facilitate the recovery of an adjustment which the IRS later determines to have been erroneous, the IRS may assess a deficiency as if it were due to a mathematical error under I.R.C. § 6213(b)(2) without providing the taxpayer with an opportunity

to dispute the assessment. Yet, such method of recovering an erroneous refund is not exclusive; the IRS may send a notice of deficiency and provide the taxpayer with an opportunity to challenge the deficiency before the Tax Court. H. Rept. No. 849, *supra* at 1945 C. B. 583.

The issue in this case is whether the tentative NOL carryback refund, filed by [redacted], but paid to New [redacted]. (the successor common parent to Old [redacted] was an erroneous refund in light of the regulations that apply to consolidated returns. Specifically, since Old [redacted] was the common parent of the [redacted] sub groups for the carryback years but New [redacted] was the successor common parent of the [redacted] sub groups during the loss year, the issue turns on whether New [redacted] was the proper party to receive payment of the tentative refunds as the successor common parent for the group.

Treas Reg. § 1.1502-77(a) provides that the common parent is the "sole agent" for the consolidated group with respect to most procedural tax matters relating to the group's tax liability for a consolidated return year, including filing claims for refund. If the common parent for the group ceases to exist, Treas. Reg. § 1.1502-77(d) provides that the dissolving common parent may designate a member of the group to serve as "agent" for the group, and such designation must be approved by the IRS. In this case, Old [redacted] designated [redacted] to serve as "agent" for the groups' pre-merger years, and such designation was approved by the Internal Revenue Service on [redacted] which was prior to the application for tentative refund, which was filed on [redacted].

Treas. Reg. § 1.1502-78 contains the rules applicable to consolidated groups when a claim for a tentative carryback adjustment has been filed.

Treas Reg. § 1.1502-78, provides, in part, as follows:

> (a) General Rule.--If a group has a consolidated net operating loss, a consolidated net capital loss, or a consolidated unused investment credit for any taxable year, then any application under section 6411 for a tentative carryback adjustment of the taxes for a consolidated return year or years preceding such year shall be made by the common parent corporation to the extent such loss or unused investment credit is not apportioned to a corporation for a separate return year pursuant to § § 1.1502-21(b), 1.1502-22(b), or 1.1502-

79(c) (or § § 1.1502-79A(a), 1.1502-79A(b), or 1.1502-79A(c), as appropriate).

[redacted], the [redacted] sub-group of New [redacted], filed the application for an NOL carryback, the Form 1139, for years that preceded the merger of Old [redacted] into New [redacted] was the corporation to which the NOL carryback was attributable. Treas. Reg. § 1.1502-78 currently permits the corporation to which the loss or credit is attributable, ([redacted], to file the application for an NOL carryback refund.

Though [redacted] was not the common parent of the new [redacted] groups, the application for transfer of funds, the Form 8302, was filed by New [redacted], the successor common parent of the [redacted] groups. The payment of the tentative refund of $[redacted] was actually paid by the IRS to a bank account owned by, and in the name of, New [redacted].

Under Treas. Reg. § 1.1502-78(b), the regulations currently specify that any refund that is claimed under Treas. Reg. § 1.1502-78(a) shall be paid to the common parent corporation. Specifically, the regulation states:

> (b) Special Rules.--(1) Payment of refund. Any refund allowable under an application referred to in paragraph (a) of this section shall be made directly to and in the name of the corporation filing the application, *except that in all cases where a loss is deducted from the consolidated taxable income or a credit is allowed in computing the consolidated tax liability for a consolidated return year, any refund shall be made directly to and in the name of the* ***common parent corporation***. The payment of any such refund shall discharge any liability of the Government with respect to such refund. [Emphasis added.]

The Tax Court has had difficulty applying the rules applicable to consolidated groups following a group structure change, under Treas. Reg. § 1.1502-75(d), where certain members of the group continue to exist and a new common parent has replaced the former common parent. See Interlake Corp. v. Commissioner, 112 T.C. 103 (1999); Union Oil Co. v. Commissioner, 101 T.C. 130 (1993); Southern Pacific Co. v. Commissioner, 84 T.C. 395 (1985).

In Interlake Corp. v. Commissioner, 112 T.C. 103, 112-113 (1999), the Tax Court found that Treas. Reg. § 1.1502-78(b) is

unclear as to whether the a tentative carryback refund should be made to the common parent in the carryback year or the common parent in the loss year, especially when the common parent for the carryback year was no longer affiliated with the group. The Court held that the former common parent of an affiliated group during the carryback year, that no longer remains affiliated with the group, cannot receive tentative refunds under Treas. Reg. § 1.1502-78(b). Thus, "common parent," as it appears in Treas. Reg. § 1.1502-78(b), means the successor common parent for the group. Id.

As a result, the Internal Revenue Service currently has proposed amendments to Treas. Reg. § § 1.1502-77 and 1.1502-78 to specify which corporation should file a claim for a refund on behalf of a consolidated group and to specify to which corporation the tentative refund shall be paid. For example, the proposed regulations amend Treas. Reg. § 1.1502-78(a) to provide that the common parent for the carryback year should file any application under I.R.C. § 6411 for a tentative carryback adjustment instead of the corporation to which the loss is attributable. In addition, the proposed amendments under Treas. Reg. § 1.1502-78(b) clarify that any refund under Treas. Reg. § 1.1502-78(a), related to a tentative carryback adjustment, must be paid to the corporation that was the common parent for the carryback year or, in the alternative, to the designated agent under Treas. Reg. § 1.1502-77(d). See Prop. Treas. Reg. § § 1.1502-78(a) and (b).

In this case, if we were to follow the proposed amendments to Treas. Reg. § 1.1502-78(a), the claim for tentative refund, filed by [redacted] on [redacted], should have been made by Old [redacted] and not [redacted], since Old [redacted] was the common parent for the carryback year. Furthermore, if we were to follow the proposed amendments to Treas. Reg. § 1.1502-78(b), the refund should have been paid to the common parent during the carryback years ([redacted] ([redacted]) and ([redacted]), which was Old [redacted], or, since Old [redacted] no longer existed, to the designated agent per Treas. Reg. § 1.1502-77(d), which was [redacted].

We have confirmed with the National Office that the proposed amendments to Treas. Reg. § § 1.1502-78(a) and (b) have not been adopted and are not applicable to the years at issue in this case. Specifically, the proposed regulations state that the changes apply to taxable years to which a loss or credit may be carried back and for which the due date of the original tax returns is after the date the final regulations are published in the Federal Register. Since the proposed amendments to Treas. Reg. § § 1.1502-78 (a) and (b) have not

yet been published as Final Regulations, we recommend following the regulations currently in effect under Treas. Reg. §§ 1.1502-78(a) and (b).

Accordingly, we conclude that the application for tentative NOL carryback refund, filed by [redacted] on [redacted], was proper because Treas. Reg. § 1.1502-78(a) currently permits the corporation to which the loss or credit is attributable to file such an application. Furthermore, we conclude that the payment of the tentative refund, in the amount of $[redacted], by the IRS to New [redacted] was proper under Treas. Reg. § 1.1502-78(b) because the current Regulation requires payment of the refund to the common parent. The Tax Court has interpreted "common parent" in these circumstances to mean the successor common parent for the consolidated group. See Interlake Corp. v. Commissioner, 112 T.C. 103 (1999).

Thus, we do not consider an erroneous refund to have been made under the facts and circumstances contained herein.

Issue 2: Notice of Deficiency Procedures to Recover NOL Carryback Refund

I.R.C. § 6411 was first enacted as § 3780 of the Internal Revenue Code of 1939 by the Tax Adjustment Act of 1945 (Act of July 31, 1945, ch. 340, 59 Stat. 521) and was accompanied by a Committee Report (H. Rept. No. 849, 79th Cong., 1st Sess. (1945), 1945 C. B. 566, 580-583) which emphasized the tentative character of adjustments made pursuant thereto. Referring specifically to subsection (c) of 1939 Code Section 3780--the predecessor of I.R.C. § 6213(b)(2), which authorizes the assessment as mathematical errors of deficiencies attributable to tentative carryback adjustments-the Committee Report states (1945 C. B. at 583):

> It is to be noted that the method provided in subsection (c) of section 3780 to recover any amounts applied, credited, or refunded under section 3780 which the Commissioner determines should not have been so applied, credited, or refunded is not an exclusive method. It is contemplated that the Commissioner will usually proceed by way of a deficiency notice in the ordinary manner, and the taxpayer may litigate any disputed issues before the Tax Court. The Commissioner may also proceed by way of a suit to recover an erroneous refund.

If the Commissioner determines that an amount which has been refunded pursuant to I.R.C. § 6411 should not have been so

refunded, he may seek to assess such amount as a deficiency in at least three distinct ways. He may assess such amount as a deficiency as if it were due to a mathematical error appearing on the return under I.R.C. § 6213(b)(2), or he may proceed by way of a deficiency notice in the usual manner. Union Equity Cooperative Exchange v. Commissioner, 58 T.C. 397 (1972); John S. Neri v. Commissioner, 54 T. C. 767, 770-771 (1970); Frank B. Polachek v. Commissioner, 22 T. C. 858, 863-865 (1954). Furthermore, the Commissioner may seek to recover the refund if he determines it was erroneous, under the procedures outlined above, pursuant to I.R.C. § 7405.

The Tax Court has held, that when as a result of an application for a tentative carryback adjustment, a refund is paid to a transferee of the corporation sustaining the loss, the Internal Revenue Service may use the notice of deficiency procedure to recover such refund if he later determines that it was erroneous. Collegiate Cap and Gown Company v. Commissioner, 59 T.C. 449 (1972).

Accordingly, if it is later determined that the NOL carryback adjustments, claimed by [redacted] on the Form 1139, but paid to New [redacted] on [redacted], are not allowable, we recommend that you make the necessary adjustments to the consolidated returns in the notices of deficiency, if any, issued for the [redacted], [redacted] and [redacted] periods. Per our memorandum to you from Marion Robus, dated October 18, 2001, we recommend, for the reasons stated therein, that the notices of deficiency be issued to both New [redacted] (EIN# [redacted], as successor to Old [redacted] (EIN# [redacted]), and [redacted] (EIN# [redacted]) as alternative agent for Old [redacted] (EIN# [redacted]). Treas. Reg. § 1.1502-77T.

If you have any questions with regard to this memorandum, please do not hesitate to contact me at (415) 744-9211.

LAUREL M. ROBINSON
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By:_____
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Attachments: Exhibits A through G

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